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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1239

MARKO DUROVIC, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 49-108) are reported at 54 T.C. 1364. The opinion of the court of appeals (Pet. App. 1-44) is reported at 487 F. 2d 36.

JURISDICTION

The judgment of the court of appeals was entered on October 18, 1973, and the petitioner's pe-

tition for rehearing was denied on November 26, 1973 (Pet. App. 1, 45). The petition for a writ of certiorari was filed on February 12, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the timely filing of partnership returns by a partnership in which petitioner was a member commenced the running of the statute of limitations for assessment and collection of deficiencies in petitioner's income taxes, where petitioner had not filed individual returns for those years, as required by Section 6012(a) of the Internal Revenue Code of 1954.

2. Whether petitioner and his wife could retroactively elect to file joint returns for taxable years with respect to which the Commissioner determined deficiencies in petitioner's income taxes based upon the rates for a married individual filing separately.

3. Whether both courts below correctly held that the cost of producing one drug was not part of the cost of producing a different drug.

4. Whether petitioner and his wife could deduct their living expenses in the United States during the years prior to their attainment of permanent visitor status.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 are set forth at Pet. 4-15.

STATEMENT

Petitioner, a lawyer of Yugoslavian birth, together with his brother, Stevan, a doctor, conducted research and experimentation on a substance to retard or control malignant growth. Between 1943 and 1946, while living in Argentina, Stevan received from a Mrs. von Martini financial advances for his work of 500,000 pesos, which petitioner repaid in 1949 (Pet. App. 52-55).

In 1944, Stevan unexpectedly isolated a substance, designated Kositerin, which appeared to control hypertension. In order to produce the substance, he established a laboratory in Buenos Aires in 1946. He obtained financial assistance from investors, and he contributed raw material sufficient to produce 40,000 ampules of Kositerin. In exchange, he was to receive 70 percent of the net proceeds if the substance was ever marketed (Pet. App. 54-57). No Kositerin was ever sold in Argentina, however, and the supply of the substance ultimately was destroyed by the Argentinian Government (Pet. App. 61, 62).

In 1947, Stevan discovered a substance designated "drug X" (later called Krebiozen), which he believed to be active against malignancies. Between 1947 and 1949, he received 3,000,000 pesos from Juan Manuel Tanoira for financing the development and production of the drug; in exchange, Tanoira received a one-half interest in any proceeds from the ultimate sale of the product, and held the 2 grams, 35 centigrams produced of the substance as security for his advances (Pet. App. 62-63).

In March 1949, Stevan left Argentina for the United States, where he hoped to continue development of Krebiozen. Meanwhile, Tanoira lost interest in the project, and, in exchange for the repayment of the 3,000,000 pesos he had invested, transferred the existing stock of "drug X" to petitioner, who had remained in Argentina. Thereafter, petitioner went to the United States with the drug. Upon his arrival, he and Stevan, as partners, established a laboratory (Duga Illinois) in Chicago and produced 200,000 ampules of Krebiozen from the existing stock of the substance. Between then and April 1954, 63,903 ampules were distributed without charge by physicians to advanced or terminal cancer patients. Efforts to license the drug failed, and after April 1954, patients were required to pay for the drug. Between 1954 and 1958, Duga Illinois received payments totalling $1,008,107.70 (Pet. App. 63-74).

For the years 1954 through 1958, Duga Illinois timely filed partnership returns reporting as income the net amounts received for the Krebiozen ampules, and claiming as offsetting deductions amounts designated "cost of goods sold." These amounts were calculated by establishing a per-ampule cost of $9.74 for 1954 and $10.32 for 1955-1958 and multiplying those figures by the number of ampules distributed each year. As a result, the partnership reported substantial losses for each of these years (Pet. App. 73-77).

Petitioner's accountant advised him that he and Stevan would not be required to file individual tax

returns because of the large losses reflected in the partnership returns. Except for interest on a joint savings account ($680 in 1957 and $891 in 1958), petitioner and his spouse had no other income during the tax years in issue (Pet. App. 76-77).

In 1959, the Internal Revenue Service audited the 1957 partnership return solely to determine the propriety of the change in per-ampule cost which had been initiated in 1955, and issued a "no change" letter as a result (Pet. App. 76). In September 1963, petitioner, Stevan, Duga Illinois, and its successor, Promak Laboratories, were audited. In that inquiry it was discovered that neither petitioner nor Stevan had filed individual tax returns for the years 1954 through 1958. The Internal Revenue Service agents were denied access to any of the Duga Illinois records by Stevan and petitioner's attorney (Pet. App. 77).

On October 28, 1964, the Internal Revenue Service made a jeopardy assessment against petitioner of $519,063.05 and levied on all assets owned by him and his wife. On December 28, 1964, a statutory notice of deficiency was issued to him, based upon the denial of the entire amount of the cost of goods sold claimed in the partnership returns. Petitioner's income was computed on the basis of a married taxpayer filing a separate return. Thereafter, on March 10, 1965, taxpayer and his wife filed late joint returns for each of the tax years 1954 through 1958 (Pet. App. 78-79).

With respect to the issues raised in the petition, both the Tax Court and the court of appeals held:

(1) that the timely filing of the Duga Illinois partnership returns did not start the running of the statute of limitations as to petitioner's individual returns because he had failed to file individual returns; (2) that petitioner and his wife could not retroactively elect to file joint returns for the years 1954 through 1958 after the Commissioner had determined deficiencies in petitioner's income taxes based on the tax rates for a married individual filing separately; (3) that the cost of developing one drug, Kositerin, was not part of the cost of goods sold with respect to another drug, Krebiozin; and (4) that petitioner and his wife were not entitled to deduct their living expenses in the United States during the years before they attained permanent visitor status.

ARGUMENT

1. Petitioner first disputes (Pet. 23-42) the holding of both courts below that the filing of the Duga Illinois partnership informational returns for the years in question did not commence the period of limitations against assessment of taxes against him.

During the years at issue, Section 6012(a)(1) of the Internal Revenue Code (Pet. 7) provided that every individual under 65 years of age having a gross income of $600 or more for the taxable year must file an individual income tax return.[1] When made on the basis of the calendar year, such re-

[1] Effective for taxable years beginning after December 31, 1971, the minimum amount of gross income for which an individual must file a tax return has been increased to $750.

turns must be filed by April 15 of the following year. Section 6072 of the Code. If the taxpayer has filed a return, Section 6501(a) of the Code provides a general statute of limitations of three years, starting from the time such return is filed (whether timely or untimely), within which the Commissioner may assess the tax. If, however, a taxpayer has not filed a return, Section 6501(c)(3) provides that taxes may be assessed and collected at any time.

Petitioner concedes (Pet. 24) that he had filed no individual tax returns for the years in issue when the Commissioner issued his notice of deficiency. Nevertheless, he urges that the timely filing of informational partnership returns should be treated as sufficient to meet the requirements for filing individual returns, thereby commencing the running of the period of limitations. However, a similar contention was unanimously rejected in *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219.

There, the filing of a corporate tax return was held not to commence the period of limitations with respect to personal holding company taxes, for which a second return was required to be filed, even though the corporate return contained a "full disclosure of * * * gross income and deductions and * * * resulting net income." *Lane-Wells Co.* v. *Commissioner*, 134 F.2d 977, 978, n. 1 (C.A. 9). As this Court stated, "[t]he purpose [of requiring the filing of two separate returns] is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task

of handling and verifying returns may be readily accomplished" (321 U.S. at 223). Thus, while the Commissioner may have been able to compute the taxpayer's personal holding company tax liability from the information disclosed on the corporate return, that fact did not commence the period of limitations in the absence of the filing of a personal holding company tax return. See also *Automobile Club* v. *Commissioner*, 353 U.S. 180; *F. E. McGillick Co.* v. *Commissioner*, 30 T.C. 1130; *Danz* v. *Commissioner*, 18 T.C. 454.

Although petitioner (Pet. 28) emphasizes that for three of the five years at issue he had no other source of gross income other than the partnership,[2] that fact is irrelevant. The essential point of the Court's *Lane-Wells Co.* decision is that the disclosure of information which may enable the Commissioner to compute an individual's tax liability does not constitute the filing of a "return" for purposes of the statute of limitations. The disclosure of the partnership's gross and net income on its informational returns was insufficient to enable the Commissioner to compute petitioner's individual tax liability, for those returns necessarily failed to disclose any non-partnership income petitioner might have had for the five years at issue, and in fact did have for two of those years.

Contrary to petitioner's argument (Pet. 26-29), the decision below does not conflict with *Germantown*

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[2] For the years 1957 and 1958, petitioner had interest income of more than $600 (Pet. App. 5).

Trust Co. v. *Commissioner*, 309 U.S. 304. There, the taxpayer filed a return on a wrong form which contained "all of the data from which a tax could be computed and assessed although it did not purport to state any amount due as tax" (309 U.S. at 308). Under such circumstances, the Court held that such a defect did not prevent the running of the period of limitations. In this case, however, the partnership informational returns did not even purport to contain all of the data upon which petitioner's tax liability could be computed.[3]

2. Petitioner further contends (Pet. 33-42) that he and his wife effectively elected the benefit of joint return rates under Section 6013(b) of the Code. His argument rests upon the fact that on March 10, 1965, he and his wife filed joint returns for the years 1954-1958, after receiving the Commissioner's determination of deficiencies which were based upon separate return rates.

Section 6013(b), however, does not afford petitioner any relief. Pursuant to that provision, married taxpayers who have filed separate returns may later elect to file joint returns provided, *inter alia*, such election is made within three years from the last

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[3] Nor does *Benderoff* v. *United States*, 398 F.2d 132 (C.A. 8), relied upon by petitioner (Pet. 27), lend any support to his argument. In that case, a Subchapter S corporate information return disclosing distributions to the taxpayer was deemed sufficient to commence the limitations period where such return was attached to the taxpayer's individual return, which did not report the corporate distributions. Unlike *Benderoff*, petitioner failed to file any individual returns to which the partnership returns should have been attached.

date prescribed by law for filing the joint return for the taxable year. Section 6013(b)(2)(B). Petitioner's late joint returns cannot qualify under the statutory election because the Commissioner's determination was based upon his authority under Section 6020(b)(1) of the Code to execute a return for any person failing to file a return.[4] As a result, petitioner's "election" for joint return status was not timely under Section 6013(b) because it was made more than three years from the date upon which the joint returns should have been filed. Rev. Rul. 70-632, 1970-2 Cum. Bull. 286;[5] cf. *Spanos* v. *United States*, 212 F.Supp. 861, 863-864 (D. Md.), affirmed on this point, 323 F.2d 108 (C.A. 4).

Indeed, had the Commissioner not exercised his statutory authority to compute petitioner's tax liability, petitioner would in all probability never have filed any returns for the years in question. The Commissioner's computation of petitioner's tax liability

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[4] Contrary to petitioner's suggestion (Pet. 35, n. 5), the Commissioner's authority to make a return for a delinquent taxpayer under Section 6020(b)(1) does not require the actual preparation of a return. It simply enables the Commissioner to compute the tax liability of a person upon information available to him.

[5] Rev. Rul. 72-539, 1972-2 Cum. Bull. 634, relied upon by petitioner (Pet. 39-40), is not in point. While that ruling permitted a taxpayer to file a joint return for a year where no return had been filed, it did not involve a situation, as in this case, where the Commissioner had exercised his authority under Section 6020(b)(1) to prepare a return for the delinquent taxpayer.

should not provide him with a basis to file untimely returns claiming the benefit of the joint rates.

3. Petitioner also challenges (Pet. 42-47) the conclusion of both courts below that the development costs of a drug, Kositerin, constituted capital expeditures and could not be included in the cost of goods sold of a second drug, Krebiozen. The result of this conclusion was that the loss realized upon the destruction of the Kositerin drug in Argentina was a nonbusiness loss and thereby not subject to the carryback and carryforward provisions of Section 172 of the Code. See Section 172(d)(4). This factual question does not warrant further review.

The undisputed facts show that Kositerin was financed and developed separately from Krebiozen and was never contributed to the Duga Illinois partnership for distribution. As a result, the expenditures incurred in connection with its development could in no way be considered part of the cost of Krebiozen sold by the partnership (Pet. App. 99-100).[6] Moreover, there is nothing in the record to substantiate petitioner's contention (Pet. 44) that he was once

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[6] Petitioner argues (Pet. 43) that his gratuitous repayment of advances made by Mrs. von Martini to Stevan long before petitioner began investing in his brother's research should be included in the computation of the costs of goods sold. Not only were the advances expended to obtain the raw material for Kositerin, rather than Krebiozen (Pet. 46), but the fact that petitioner himself was never under any obligation to repay the amounts is not disputed. The repayment constituted nothing more than a gratuitous act undertaken out of family considerations, and petitioner's assertions to the contrary were properly rejected by both courts below.

in the trade or business of selling Kositerin. In fact, petitioner was never engaged in selling or holding himself out as engaged in selling Kositerin either in Argentina or the United States (Pet. App. 61-62). Accordingly, his losses incurred with respect to this activity are not eligible for carryback or carryforward treatment under Section 172.

4. Finally, petitioner urges (Pet. 48-53) that his and his wife's living expenses from 1949 until mid-1952 when they attained permanent visitor status were deductible as "away from home" business expenses. But the term "home" as used in the tax law means a taxpayer's principal place of business or employment. *Markey* v. *Commissioner*, 490 F.2d 1249, 1253-1255 (C.A. 6), and cases cited therein. Here, petitioner and his wife came to the United States with the intention of engaging in business with respect to Krebiozen over an indefinite period, and there can be no doubt that the United States was their principal place of business thereafter. Indeed, it was their only place of business. Despite petitioner's suggestion to the contrary (Pet. 50), the concept of "indefinite," as opposed to "temporary," employment away from home is well established in the tax law. See 4A Mertens, *Law of Federal Income Taxation* (Rev.), § 25.93, nn. 78.21-78.23. See also *Kinsey* v. *Commissioner*, 33 T.C.M. 126.

Moreover, there is no authority for petitioner's contention (Pet. 50-51) that the principles that govern an immigrant's status for purposes of allowing him to remain in the country have any effect upon his tax

status. To the contrary, the Tax Court has held that a person conceded to be a non-resident alien employed in the United States is entitled to no more liberal treatment in regard to the deductibility of personal expenses than any other taxpayer. *Carranza (Zuri)* v. *Commissioner*, 11 T.C. 224. See also *Mitnick* v. *Commissioner*, 13 T.C. 1; and Rev. Rul. 73-578, 1973-52 Int. Rev. Bull. 8.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

SCOTT P. CRAMPTON,
Assistant Attorney General.

GRANT W. WIPRUD,
JANE M. EDMISTEN,
Attorneys.

MAY 1974.

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